



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF
CHIEF COUNSEL

September 13, 2002

Number: **200250019**
Release Date: 12/13/2002
U.I.L. #s: 6213.07.01, 72.20-00

CC:TEGE:EB:QP2
SCAF-131407-02

MEMORANDUM FOR ASSOCIATE AREA COUNSEL
(SMALL BUSINESS/SELF-EMPLOYED: AREA 1)
CC:SB:1:LI
Attn: PATRICIA RIEGGER

FROM: CHIEF, QUALIFIED PLANS BRANCH 2 (EMPLOYEE
BENEFITS)
OFFICE OF THE DIVISION COUNSEL/ASSOCIATE CHIEF
COUNSEL (TAX EXEMPT AND GOVERNMENT ENTITIES)
CC:TEGE:EB:QP2

SUBJECT: MATH ERROR PROCEDURES AND I.R.C. § 72(t)
REQUEST FOR SIGNIFICANT SERVICE CENTER ADVICE

This significant Service Center Advice responds to your memorandum dated June 27, 2002, regarding an inquiry you received from the Brookhaven IRS Campus on June 10, 2002. They wanted to know whether math error procedures could be used to assess 10% additional tax under I.R.C. § 72(t) for early withdrawals from an IRA.

ISSUES

Issue 1: Whether math error procedures may be used to assess the 10% tax under section 72(t) for early distribution from an Individual Retirement Account ("IRA") based upon the payer filing a Form 1099-R, Distributions From Pensions, Annuities, Retirements or Profit Sharing Plans, IRAs, Insurance Contracts, etc., listing code "1" (the code for early distribution) in box 7 (Distribution code) when the taxpayer seeks reconsideration of an assessment made pursuant to a defaulted notice of deficiency that did not include the 10% tax and the taxpayer fails to include the 10% tax on the delinquent original federal income tax return submitted after assessment of the defaulted notice.

Issue 2: Whether a formal notice of claim disallowance should be sent to a taxpayer when the 10% additional tax under section 72(t) has been assessed pursuant to a defaulted notice and the taxpayer subsequently submits a federal income tax return that does not include the 10% additional tax.

CONCLUSIONS

1. A notice of deficiency should be issued when asserting the 10% tax under section 72(t) given the factual situation described. Math error procedures are not appropriate.
2. The Internal Revenue Code does not mandate the issuance of a formal notice of claim disallowance. Section 6532(a), however, provides that the notice of claim disallowance must be sent to commence the running of the two year period to file a refund suit.

FACTS

Payers file Forms 1099-R, with the Internal Revenue Service ("Service") reporting distributions from IRA's. A matching program will identify persons who have failed to file federal income tax returns where there is unreported income. In some instances, the unreported income will be derived, at least in part from distributed income reported by payers on the Forms 1099-R. ASFR (Automated Substitute for Return) will send a statutory notice of deficiency based on the unreported income to a taxpayer who has failed to file a federal income tax return for the year at issue. The taxpayer does not file a petition with the Tax Court and assessments are made pursuant to a defaulted statutory notice of deficiency. The taxpayer will then seek reconsideration from ASFR after the assessment. The taxpayer provides the delinquent original federal income tax return upon reconsideration. The taxpayer is not required to file the Form 1099-R with the federal income tax return since that is the filing requirement of the payer. ASFR adjusts the tax to reflect that which is reported on the return.

When the notice of deficiency is issued asserting unreported income from an IRA, the notice should also assert the 10% tax on early distribution under section 72(t). Apparently, the 10% tax is not being asserted in many of the notices of deficiency. As we understand it, there are taxpayers seeking reconsideration where the 10% tax was not asserted in the notice. These taxpayers will come in for reconsideration and supply a return which fails to include the 10% tax. The Form 1099-R is not included with the return. ASFR then assesses the 10% tax under math error procedures.

The rationale for the use of math error procedures is based upon the payer listing code "1" (the code for early distribution) in box 7 ("Distribution code") on the Form 1099-R which the payer files with the Service while the taxpayer fails to set forth the tax on the federal income tax return. Associate Area Counsel has orally advised that if additional tax was not included in the notice of deficiency or original return, then deficiency procedures must be followed.

In other instances, the 10% tax is included in the notice of deficiency and assessed pursuant to the defaulted notice. The taxpayer comes in for reconsideration and

SCAF-131407-02

submits an original return but fails to include the 10% tax on the return. Associate Area Counsel has orally advised that the assessment should not be abated and that a notice of claim disallowance should be issued.

ANALYSIS

Section 72(t) of the Code provides for a 10% additional tax on early distributions from qualified retirement plans. The additional tax is includible in gross income but does not apply to certain distributions, such as those made on or after the employee reaches the age of 59½ years of age; those made to a beneficiary or estate of an employee after the employee's death; and those attributable to an employee's disability, among other exceptions.

Issue 1:

The failure to report on the return the 10% tax on early distribution under section 72(t) creates a deficiency since the correct tax will be more than the tax shown on the submitted return. Under section 6213(a) of the Code, the Service may not assess a deficiency until the period to petition the Tax Court has expired or, if the taxpayer files a petition, until the Tax Court's decision becomes final. Section 6213(b)(1) provides an exception that allows summary assessment of tax based on a correction of a math or clerical error. Section 6213(g)(2) enumerates the situations whereby math error procedures may be used to assess tax. If a fact pattern does not specifically fall into one of the 13 enumerated circumstances, math error procedures should not be used.

The request for Significant Service Center Advice from Associate Area Counsel posits that the only possible relevant subsection to the facts at hand is found in section 6213(g)(2)(C). Section 6213(g)(2)(C) defines "math or clerical error," to include an "entry on a return of an item which is inconsistent with another entry of the same or another item on such return." Section 6213(g)(1) defines "return" to include "any return, statement, schedule, or list, and any amendment or supplement thereto...." Here the Form 1099-R is filed by the payer not the taxpayer. The Form 1099-R is a separate and distinct return from the federal income tax return filed by the taxpayer so section 6213(g)(2)(C) does not apply by its own terms.

Even if Form 1099-R was considered as part of the taxpayer's federal income tax return, the Service could not readily determine whether the entry on the Form 1099-R or the entry on the Form 1040 was "correct." The taxpayer may not be liable for the 10% penalty in certain instances where the payer list code "1" in Box 7. Therefore, it would not be apparent from the face of the return whether an entry is inconsistent with another entry. The legislative history states that summary assessment procedures cannot be used where the Service is merely resolving an uncertainty against the taxpayer. They

SCAF-131407-02

cannot be used where it is not clear which of the inconsistent entries is the correct one. See H.R. Rep. No. 658, 94th Cong., 1st Sess. 291, 1976-3 C.B. (Vol. 2) 695, 983.

Section 6213(g)(2)(D) of the Code also does not allow math error procedures to be utilized under the instant facts. That section defines a mathematical or clerical error as “an omission of information which is required to be supplied on the return to substantiate an entry on the return. That language was construed to mean the omission of an entire schedule which the taxpayer is required to file with the federal income tax return. Here the payer lists code “1” in box 7 on the Form 1099-R, a separate return from the taxpayer’s federal income tax return. There is no line on the taxpayer’s federal income tax return requiring such a code listing.

The exception under section 6213(g)(2)(E) is also inapplicable. That subsection states that a math error may be:

an entry on a return of a deduction or credit is an amount which exceeds a statutory limit imposed by subtitle A or B, or chapter 41, 42, 43, or 44, if such limit is expressed - (i) as a specified monetary amount, or (ii) as a percentage, ratio, or fraction, and if the items entering into the application of such limit appear on such return.

In the factual situation presented, there is no issue with respect to an entry of a deduction or credit on the federal income tax return. An example of an applicable entry would be an entry claiming the medical expenses deduction under section 213, without meeting the floor requirements of 7.5% of adjusted-gross-income.

There is no other subsection under section 6213(g)(2) which remotely relates to the situation at hand.

Issue 2:

In some instances, the 10% tax is included in the notice of deficiency and assessed pursuant to the defaulted notice. The taxpayer comes in for reconsideration and submits an original return but fails to include the 10% tax on the return. The Service is not required to abate the 10% tax where the taxpayer fails to establish that the 10% tax does not apply. The Internal Revenue Code does not mandate that the Service issue a formal notice of claim disallowance. Section 6532(a), however, provides that the notice of claim disallowance must be sent to commence the running of the two year period to file a refund suit.

This response was coordinated with the Special Counsel (Tax Practice & Procedure) Administrative Provisions & Judicial Procedure (CC:PA:APJP:B03). If you have questions call